



## An Alternative to a Special Needs Trust? The ABLE Account

On Dec. 19, 2014, President Obama signed the “Achieving a Better Life Experience Act of 2014” or more succinctly “The ABLE Act of 2014.”

This act amends Section 529 of the Internal Revenue Code of 1986 to include Section 529A. An ABLE account resembles a “first party” special needs trust in that it is a mechanism for the individual

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with a disability, his family or friends to contribute money for the his special or supplemental needs without affecting his means-tested government benefits. The ABLE account sounds a bit like the Section 529 college savings plan because the earnings grow tax-free, if certain rules are followed. However, the ABLE account is a hybrid of special needs and tax planning that affects only the population of people who were blind or disabled before the age of 26.

### A Mini-Refresher on Special Needs Trusts

Before jumping into the ABLE rules, let’s review special needs trusts so that we can help our client or his family decide whether a special needs trust or an ABLE account, or both will be a better fit for him. Special needs trusts are divided into two categories: *first-party* special needs trusts and *third-party* special needs trust. A first-party special needs trust is used when an individual who is blind or disabled receives a windfall, such as funds from a personal injury case. Depending on the facts, we may use either a trust authorized by 42 U.S.C. Section 1396p(d)(4)(A) or a “pooled trust” authorized by 42 U.S.C. 1396p(d)(4)(C).

First-party special needs trusts *must* have a payback provision, so that the beneficiary will retain his means tested government benefits, such as Supplemental Security Income (SSI) and Medicaid. A payback provision states that at

the beneficiary’s death, any funds remaining in the trust shall be distributed to the state for allocation between the state and federal governments according to the amount each paid for the beneficiary’s care in Medicaid benefits.

The (d)(4)(A) special needs trust must be established by a parent, grandparent, court or guardian, and it must be established and funded before the beneficiary reaches age 65. The source of the funds in this special needs trust first belonged to the beneficiary because of a windfall or excess earnings. Once deposited to the trust, the funds are not counted as a resource for purposes of his means-tested government benefits.

A pooled trust may be established by a court, parent, grandparent, guardian *or the beneficiary*. A plain reading of the statute indicates that there is no age restriction on the pooled trust. This is the *only* first-party special needs trust available to our clients over the age of 65. Once the funds are deposited with the pooled trust, they are not counted as resources for the disabled individual.

A third-party special needs trust is a trust established and funded by someone other than the disabled beneficiary. I like to call this the “Mom and Pop” trust because parents and grandparents of kids with special needs need to have this special needs trust in their estate plan. A third-party special needs trust may be established by anyone on behalf of a beneficiary with a disability.

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One important difference between the first-party trusts, the ABLE account and a third-party special needs trust is that a payback provision is not required for the third-party trust. That means that when the beneficiary with a disability dies, the funds remaining in the special needs trust are distributed to beneficiaries (often the siblings) named by the (now deceased) third party who included the special needs trust in her estate plan. The funds in a third-party special needs trust are not subject to reimbursement to the Medicaid program because the funds belonged to someone other than the disabled individual.

### What Are the ABLE Account Rules?

The ABLE Act authorizes the states to establish and maintain an ABLE program. The disabled individual must be a resident of the state in which the fund is established, unless the state contracts with another state to manage the ABLE program. The individual with a disability, or someone on his behalf, may establish the ABLE account, change the investments twice per year, and request withdrawals for “qualified expenses.” If withdrawals are used for qualified expenses, then the ABLE account grows tax-free, and the distribution to the beneficiary is not considered income for tax purposes.

“Qualified expenses” will be further defined by the regulations, but Congress stated in the act that “any expenses related to the eligible individual’s blindness or disability which are made for the benefit of an eligible individual who is the designated beneficiary, including the following expenses: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes

of this section.” Obviously, we must wait on the regulations to know the boundaries for qualified expenses.

As a general rule, the funds in the ABLE account and the disbursements from the ABLE account are exempt for income tax purposes and exempt as a resource for any means-tested government benefit. However, there are two exceptions. First, SSI classifies distributions of funds to the SSI beneficiary for food and shelter, or related expenses, to be “income.” (This is not the same as the IRS definition of income.) Often, such distributions will reduce the SSI recipient’s monthly SSI amount to \$0. If SSI is reduced to \$0, the consequences are dire because he will lose his Medicaid benefit.

However, with an ABLE account, if a distribution is made for housing, and the distribution reduces the monthly SSI to \$0, then the SSI beneficiary will lose his Supplemental Security Income, but ***he will retain his Medicaid benefit.*** Remember that this exception, allowing the SSI to be reduced to \$0, but the beneficiary retains his Medicaid benefit, ***only*** applies to people who were disabled before age 26, the individual has an ABLE account, and his SSI was reduced to zero, even though the funds were used for qualified expenses.

The second exception to the ABLE Act’s blanket rule that the ABLE account is exempt for any means-tested government benefit, is that if the beneficiary’s ABLE account exceeds \$100,000, then the beneficiary ***will lose his SSI, but he will retain his Medicaid benefit.*** One commentator opined that the states will probably allow the accounts to have more than \$100,000 in the ABLE accounts; however, those funds over \$100,000 will not receive favorable tax treatment. In addition, if a beneficiary requests a distribution, and he does not use it for a “qualified expense” those funds will be included in gross income and there will be a monetary penalty imposed by the IRS for withdrawing those funds.

Reaching \$100,000 in an ABLE account will take time since the aggregate of all contributions in one year may

not exceed the annual gift tax exclusion (\$14,000 in 2015), and the ABLE beneficiary is limited to one ABLE account. In other words, if Uncle Harry and Aunt Sally each deposit \$5,000 into Johnny’s ABLE account for his birthday, then Johnny’s Grandma is limited to a contribution of \$4,000.

After the beneficiary dies, the ABLE account *may be used to pay outstanding qualified expenses including a funeral.* After the beneficiary’s death, and the payment of outstanding qualified expenses, the state may be reimbursed for Medicaid benefits paid on behalf of the beneficiary. This is in contrast to the pooled trust and the (d)(4)(A) trust in which the trustee may not make any distributions after death other than a distribution to the state Medicaid agency or a distribution to the estate or revocable trust of the decedent.

**Is a first-party special needs trust or an ABLE account most advantageous for my client who was disabled before the age of 26?** Of course the answer is “*it depends.*” The chart at right shows a comparison of first-party trusts, a third-party trust and an ABLE account.

The ABLE account has been lauded as a place for families and friends to contribute funds for the benefit of the person with a disability. That’s understandable if it is Grandma’s \$50 birthday check. However, in most cases, a third party, such as Grandma, would not be happy if she understood that the funds she contributed to an ABLE account or any other *first-party* special needs trust account may be used to reimburse the Medicaid program. Grandma, Mom and Pop should establish a special needs trust in their estate plan because then they have control over who receives the funds after the beneficiary’s death. Grandma’s small birthday check should go into the individual’s regular checking account or his ABLE account depending the facts and circumstances.

An ABLE account is an excellent tool for the beneficiary’s excess earnings. Often an SSI beneficiary will be involved in a work program and have a small amount of income each month. Those

## Comparison of Special Needs Trusts with an ABLÉ Account

Trust Type	First-Party Special Needs Trust (42 USC 1396p(D)(4)(A))	First-Party Special Needs Pooled Trust (42 USC 1396p(D)(4)(C))	ABLE Account	Third-Party Special Needs Trust "Mom & Pop" Trust
<b>Is there an age limitation?</b>	This trust must be established and funded before age 65.	No age restriction in federal law.	Beneficiary must have been disabled before age 26.	No age limitation.
<b>Is there a limit on annual contributions?</b>	No.	No.	Yes. The aggregate of all contributions may not exceed the annual gift exemption (\$14k for 2015).	No. In fact a third party may wait to fund a special needs trust until the third party dies.
<b>Is there a limit on the total amount that may be held in the trust or account?</b>	No.	No.	Yes, the limit will be set by the states. However, if the funds in the account exceed \$100,000, the beneficiary loses his SSI but retains Medicaid.	No.
<b>Are the earnings in the ABLÉ account investments taxed?</b>	Yes.	Yes.	No, if the distributions from the account pay for "qualified expenses."	Yes.
<b>Who may establish the trust or account?</b>	A parent, grandparent, court or guardian.	The <i>beneficiary</i> , parent, grandparent, court or guardian.	The <i>beneficiary</i> or "someone" on the beneficiary's behalf.	Any third party may establish a special needs trust.
<b>May the beneficiary be changed?</b>	No.	No.	Yes, as long as it is a brother, sister, step-brother or step-sister who meets the ABLÉ Act requirements.	It depends on the language in the document and/or whether the third party is dead or alive.
<b>May distributions be made after the beneficiary's death, to pay outstanding qualified expenses including a funeral?</b>	No.	No.	Yes, for outstanding qualified expenses, including a funeral. It appears that "someone" may change the beneficiary to a qualified family member.	Yes.
<b>May the State seek reimbursement for Medicaid expenditures?</b>	Yes.	Yes, to the extent that the funds are not retained by the Trustee for the benefit of other disabled beneficiaries.	Yes.	<b>NO.</b>

funds often drive the countable resources of the individual with a disability over the \$2,000 threshold. In the past, most of these beneficiaries are the ward of a conservatorship, so we would have to petition the court to establish the (D)(4)(A) trust. However, an ABLÉ account may be an excellent vehicle for the beneficiary with a disability to deposit his extra earnings, and it does not appear that court approval is required to establish

or fund the account.

The ABLÉ Act of 2014 has added another tool to improve the quality of life and care for those individuals who were disabled before the age of 26. The ABLÉ account will be useful for a beneficiary's excess earnings, those Christmas and birthday cards that rain cash or a small windfall. However, because of the \$14,000 aggregate annual limit on contributions, we will continue to need first-party special needs trusts, and of

course, the ABLÉ account should not take the place of a third-party or "Mom and Pop" trust. The ABLÉ Act is effective for 2015. <sup>17</sup>

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